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IN THE

Supreme Court of the United States

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No. OCTOBER TERM, 1941

MIFFLINBURG BODY COMPANY, DEBTOR,
Petitioner

vs.

MIFFLINBURG BANK AND TRUST COMPANY

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

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TO THE HONORABLE, THE CHIEF JUSTICE AND THE ASSOCIATE JUSTICES OF THE SUPREME COURT OF THE UNITED STATES:

Your Petitioner, Clarence P. Wynne, Trustee in Reorganization Proceedings of the Mifflinburg Body Company, respectfully prays this Court for the issuance of a Writ of Certiorari to the Circuit Court of Appeals for the Third Circuit, to review a final decree of that Court entered on April 2, 1942, reversing the order of the District Court of the United States, for the Middle District of Pennsylvania, entered October 3, 1941.

OPINIONS BELOW

The Opinion of the District Court (R., pp. 4a-10a) is reported in 41 F. Supp. 9.

The Opinion of the Circuit Court of Appeals, (R., pp. 19-24), has not yet been reported.

JURISDICTION

The decree of the Circuit Court of Appeals, which the Petitioner seeks to have reviewed, was filed April 2, 1942 (R., p. 25).

The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925, c. 229, 43 Stat. 938.

THE CONSTITUTIONAL PROVISION INVOLVED

The constitutional provision involved is Article 16, Section 7 of the Pennsylvania Constitution of 1874, which is printed in the Appendix, infra, page 16.

QUESTION PRESENTED

The question is:

When a Pennsylvania Corporation pledges its bonds to a Pennsylvania Bank to secure a pre-existing indebtedness owing from the corporation to the Bank upon promissory notes discounted in the regular course of business, in the absence of any promise by the corporation at the time the loans were made, that bonds were to be given as collateral, and in the absence of any promise by the

Bank, at the time or before the bonds were pledged, to forbear or extend the loans, and in the absence of any advances made by the Bank after the bonds were pledged, are such bonds invalid in the hands of the Bank as a contravention of Article 16 Section 7 of the Pennsylvania Constitution of 1874?

STATEMENT

The Mifflinburg Body Company and Mifflinburg Bank and Trust Company are Pennsylvania corporations. At various times prior to 1935, the company borrowed moneys from the bank by discounting trade acceptances with it. Occasionally the company substituted its own notes for some of the trade acceptances. No new loans were made after 1935. (R. pp. 12a, 13a).

On April 1, 1938, the company executed and delivered to the bank as trustee for bondholders, a mortgage for $150,000 upon its plant and equipment to secure a bond issue of the same amount. From the sale of some of these bonds it realized $36,800 in cash. It applied the major portion of the cash towards the indebtedness which was thereby reduced to $93,328.00, (R. pp. 13a, 14a).

The Bank, on instructions of the Banking Department of the Commonwealth of Pennsylvania, demanded additional collateral as security for the indebtedness. On October 20, 1938, more than three years after the creation of the indebtedness, the Company delivered bonds having a face value of $95,000 to the Bank as collateral security, (R. pp. 14a, 15a).

On June 11, 1940, the creditors petitioned for the reorganization of the Company under Chapter X of the Bankruptcy Act. The petition was duly approved and Clarence P. Wynne, was appointed Trustee, (R. p. 15a).

On August 31, 1940, the Bank filed a proof of claim in the reorganization proceedings as a secured creditor

and petitioned that the Court determine the value of the pledged bonds. The Trustee filed objections to the Bank's claim as a secured claim, (R., pp. 15a, 11a).

The matter was referred by the District Court, on September 3, 1940, to J. W. Crolly, Referee in Bankruptcy, as Special Master, for hearing, report and recommendation. The Special Master, after taking testimony, filed his report recommending that the District Court enter an order setting aside and declaring null and void the pledge of bonds and that the Bank be denied the right to participate as a secured creditor in the reorganization proceedings, (R., pp. 11a, 12a).

The Bank filed objections to the report. After argument heard, the District Court, in an opinion by Watson, J., filed on October 3, 1941, held the bonds were issued in contravention of Article 16, section 7 of the Constitution of Pennsylvania, which prohibits the issuance of stocks or bonds "except for money, labor done, or property actually received" and were therefore void. The Court accordingly ordered that the Bank be treated as an unsecured creditor, (R., p. 12a).

On October 31, 1941, the Bank filed its notice of appeal to the U. S. Circuit Court of Appeals for the Third Circuit, together with bond for costs on appeal, (R., p. 3a).

After argument on Appeal, the Circuit Court, in an opinion filed April 2, 1942, reversed the order of the District Court.

SPECIFICATIONS OF ERROR

The Circuit Court of Appeals, for the Third Circuit, erred—

1. In holding that corporate bonds pledged to a bank by the Petitioner, a Pennsylvania corporation, to secure a pre-existing debt, are valid in the absence

of any promise by the corporation at the time the debt was incurred that the bonds were to be given as collateral, and in the absence of any promise by the bank at the time or before the bonds were pledged to forbear or extend the loans, and in the absence of any advances made by the bank after the bonds were pledged.

2. In holding that the bonds pledged by the Petitioner to the Mifflinburg Bank and Trust Company were not issued in contravention of Article 16, Section 7 of the Constitution of the Commonwealth of Pennsylvania.

3. In reversing the Order of District Court which directed that the entire claim of the Mifflinburg Bank and Trust Company be considered as an unsecured claim.

REASONS FOR GRANTING THE WRIT

The discretionary power of this Court to grant the writ requested is invoked because the Circuit Court of Appeals for the Third Circuit:

1. Has interpreted an important provision of the Pennsylvania Constitution in a manner which is in conflict with the interpretation inferentially placed upon it by the State Courts of Pennsylvania;

2. Has interpreted an important provision of the Pennsylvania Constitution in a manner which is in conflict with the interpretation inferentially placed upon the same provision by the same Court;

3. Has interpreted an important question of Pennsylvania Law in conflict with applicable decisions of other Circuit Courts of Appeals and other State Courts.

I.

THE CIRCUIT COURT HAS INTERPRETED AN IMPORTANT PROVISION OF THE PENNSYLVANIA CONSTITUTION IN A MANNER WHICH IS IN CONFLICT WITH THE INTERPRETATION INFERENTIALLY PLACED UPON IT BY THE STATE COURTS OF PENNSYLVANIA.

The exact question here involved has never been ruled upon by the Appellate Courts of Pennsylvania.

The Circuit Court, in this case, after admitting this fact, bases its decision on two Pennsylvania cases which it claims passed upon "the elements" contained in the fact situation.

The first is the case of WRIGHTSVILLE HARDWARE CO. vs McELROY, 254 Pa., 422, 98 A. 1052, (1916), cited by the Circuit Court for the proposition that bonds issued in payment of outstanding corporate notes were not issued in contravention of the Constitutional provision. But this is not authority for the conclusion that bonds pledged to secure a pre-existing debt are valid. In the Wrightsville Hardware Company case, bonds of the Wrightsville Hardware Company were delivered by the Company to A, in exchange and surrender by A of the Company's notes and an indemnity agreement held by A. In other words, the Wrightsville Hardware Company received as a consideration for its bonds a return of the notes with the collateral agreement of indemnity. The Court, in sustaining the validity of the transaction, did not rule on the question raised in the present case.

The second case relied on by the Circuit Court is that of MILLER vs HELLAM DISTILLING CO., (No. 1), 57 Pa. Super. Ct., 183 (1914), which the Circuit Court cited for the proposition that bonds pledged for a loan less than their face value were not issued in violation of the constitutional provision. The language used by the Superior Court in that case, however, instead of warranting the

conclusion that the pledge for a pre-existing debt is valid does the opposite.

In MILLER v. HELLAM DISTILLING CO (No. 1), 57 Pa. Super. Ct., 183, it was decided that bonds pledged as collateral for a *present* indebtedness was a compliance with the constitutional provision. The Court says, (bottom of page 189):

> "The consideration which inured to the Company for the delivery of the bonds in pledge was the money it received on its notes It is fairly to be assumed that *without the collateral the loan would not have been granted.*" (Italics ours).

In construing the question of a pledge similar to that in this case, Mr. Justice Kephart, quoting from the Supreme Court of California, says (Middle of page 190):

> "When the bonds were so pledged and money or other property was actually received *in consequence* of such use of them, it seems to us that in a just and natural sense the bonds were issued *'for'* such money or property." (Italics ours).

The above quoted language of the Pennsylvania Superior Court is in harmony only with the conclusion that the loan was made simultaneously with the pledging of the collateral.

The foregoing case is reported in the Court below in 27 York Legal Record 8. The Court below, in passing upon the legality of these Hellam Distilling Company bonds, says:

> "The bonds cost the pledgees money; they received them only by paying money for the use of the corporation."

And states further:

> "If the bonds were issued to the directors to protect them on pre-existing obligations . . . such attempted preferences would be of no avail. There is no evidence of any such thing having been done."

It is therefore evident (a) that the bonds were pledged as collateral to secure the payment of a then present loan; (b) that, had they been issued to protect the holders of a loan on pre-existing obligations, such transactions would be void.

The decision of the Circuit Court is in conflict with this conclusion. The bonds in the present case were not given in pursuance of any promise, made at the time the debts were created, that the Company would subsequently pledge the bonds, or any promise made by the Bank that if it received the bonds it would forbear, or extend, or loan new money. The Bank gave nothing for the bonds. The corporation, on the other hand, had nothing immediately after the bonds were delivered that it did not have before, although the giving of the bonds effected the giving up of certain assets which immediately prior to such giving were available to all creditors.

The uncertainty resulting from the conflict between the decision of the Circuit Court and the conclusion on this question fairly and logically deduced from the expressions of the State Courts of Pennsylvania calls for an authoritative ruling by this Court.

II.

THE CIRCUIT COURT HAS INTERPRETED AN IMPORTANT PROVISION OF THE PENNSYLVANIA CONSTITUTION IN A MANNER WHICH IS IN CONFLICT WITH THE INTERPRETATON INFERENTIALLY PLACED UPON THE SAME PROVISION BY THE SAME COURT.

In the case of RAHWAY NATIONAL BANK v. THOMPSON NATIONAL BANK, ET AL., C. C. A., 3rd Circuit, (1925), 7F. (2d) 419, it was held that, under the constitutional provision of Pennsylvania providing that "bonds of a corporation shall not issue except for money or property actually received", where there has been an agree-

ment between the lending bank and the borrowing corporation at the time the loan was made, or before, that bonds shall be issued and be deposited for collateral, the fact that they were not delivered until after the loan had actually been made, would not constitute the depositing or issue of bonds for pre-existing indebtedness. It was further held that the issuing related back to the date of the agreement to deposit the bonds . . . and that the loan was made in pursuance of and upon the faith of a promise that bonds of the corporation would be deposited with the bank.

The Court says "it will be assumed but not decided that the Constitution of the State of Pennsylvania, Article 16, Section 7&c. denies to a Pennsylvania corporation power to issue its bonds in consideration of a pre-existing indebtedness, and that the trustee's major premise is sound;" and then proceeded to decide the case upon the theory that the bonds were not delivered to secure a pre-existing indebtedness.

The Circuit Court of Appeals for the 3rd Circuit, in the case of WOOD & SONS v. SOUTHERN TRUST CO., and WOOD & SONS v. ROBINSON-RODERS CO., 13 F. (2d), 367, C. C. A. Third Circuit, (1926), had an opportunity to consider a New York statute identical with the Pennsylvania constitutional provisions. In that case it held that where bonds of a corporation are pledged as security for prior loans, made with the *understanding that when the bonds would be issued,* they should be pledged for the loan, is not a pledge to secure an antecedent debt under the provisions of the law of New York.

Judge Wooley, speaking for the Court, after reciting the provisions of the corporation law of New York to the effect that no corporation shall issue bonds "except for money or property actually received", states: *"That bonds issued to secure an antecedent debt are invalid under New York law cannot be doubted, and so a pledge of the new issued bonds to secure an antecedent debt is equally invalid, recognizing that law,* the question in dis-

pute is whether as matters of fact the pledges here involved were made to secure debts of that kind"; and then proceeds to determine and does determine that the loans were made in pursuance of an *understanding entered into* between the bank and the corporation *at the time the loans were made* that as soon as the bonds could be issued they would be pledged as collateral. In other words, the Court found that the loans were made upon the faith of the bonds which were to be pledged.

In the foregoing case this Court expressly states:

> "That bonds issued to secure an antecedent debt are invalid under New York law cannot be doubted, and so a pledge of new issued bonds to secure an antecedent debt is equally invalid."

The New York statute is as follows:

> "No corporation shall issue either stock or bonds except for money, labor done, or property actually received for the use and lawful purposes of such corporation"

and is identical with the Pennsylvania constitutional provisions. Nevertheless, the Circuit Court of Appeals for the Third Circuit, in the absence of any clear-cut supporting Pennsylvania authorities, now interprets the Pennsylvania Constitutional provision in conflict with the interpretation it has followed on the New York statute and in conflict with the interpretation it had inferentially placed on the constitutional provision in RAHWAY NATIONAL BANK case.

III.

THE CIRCUIT COURT HAS INTERPRETED AN IMPORTANT QUESTION OF PENNSYLVANIA LAW IN CONFLICT WITH APPLICABLE DECISIONS OF OTHER CIRCUIT COURTS OF APPEALS AND OTHER STATE COURTS.

The interpretation chosen by the Circuit Court in this case is clearly against the weight of authority. As ad-

mitted by the Circuit Court in its opinion, it aligns Pennsylvania law with that of only two other jurisdictions: Alabama and Wisconsin; and against that of six other jurisdictions: New York, California, Missouri, Montana, S. Dakota and Texas.

In the case of PROGRESSIVE WALL PAPER CORPORATION, 229 F., 489, (1916), decided by the Circuit Court of Appeals for the 2nd Circuit, the Trustee in bankruptcy petitioned the Court for an order compelling a bank to turn back to him bonds which had been pledged by the corporation to the bank as security for an antecedent debt. The question arose under the statute of New York whether or not an antecedent debt constituted a valid consideration for bonds. The statute provides—

> "No corporation shall issue either stock or bonds except for money, labor done, or property actually received for the use and lawful purposes of such corporation."

The Court holds that an antecedent debt did not constitute a valid consideration for the bonds, and directed the bonds to be turned back to the trustee.

In the case of IN RE: PAUL DELANEY CO., 23 F. (2d), 737, (1927), decided by the District Court of New York, the question arose whether or not bonds of a corporation pledged as collateral for an antecedent debt were legally held by the pledgee or whether they were issued in violation of Section 69 of the Stock Corporation Act of New York, quoted hereinabove. The corporation pledged its bonds to a bank as collateral for a present loan of $150,000., and then used the proceeds to pay off a preexisting loan with the same bank for the same amount. One contention was that the bank agreed to extend the due note of the loan and that that constituted compliance with the Statute. The Court said:

> "Extension of time of payment of a pre-existing indebtedness does not satisfy the requirement of the Statute, because the corporation does not receive *in*

return money, labor or property within the meaning of the statute." (Italics ours) And holds further, "Unless the pledge is *contemporaneous* with the loan, or was induced by the promise to pledge the corporate bonds as security, the pledge is invalid." (Italics ours).

This case was passed upon by the Circuit Court of Appeals for the Second Circuit, 26 F. (2d) 961, which reversed in part the conclusions, but affirmed the conclusion that the issue of the bonds as collateral for a pre-existing debt did not result in the receipt by the corporation of money or property in exchange for the bonds.

To the same effect was FARMERS' LOAN & TRUST CO. vs. SAN DIEGO STREET CAR COMPANY, 45 F. 518 (1891), in which the Circuit Court of Appeals for California construed a similar constitutional provision of California.

The case of KEMMERER vs. ST. LOUIS BLAST FURNACE CO., 212 F. 63, (1914), decided by the Circuit Court of Appeals for the 8th Circuit, involved the construction of the constitutional provision of Missouri, as follows:

> "No corporation shall issue stock or bonds except for money paid, labor done, or property actually received."

The statutory provision in pursuance of above is:

> "The stock or bonds of a corporation shall be issued only for money paid, labor done, or money or property actually received."

The Court holds that bonds issued to secure a pre-existing indebtedness are invalid, stating—

> "No consideration whatever passed from the W. Company to the F. Company at the time the bonds were issued and pledged."

In MUDGE vs BLACK, SHERIDAN & WILSON, C. C. A. 8th Circuit (1915), 224 F. 919, the same Court, in con-

struing the above quoted Missouri statute, which is the same as our constitutional provision, says:—

> "Bonds of a corporation of Missouri issued by it to secure an antecedent debt, with no new consideration, except an extension of the maturity of the debt, are void by virtue of the constitutional or statuory provision of that State, prohibiting its corporations from issuing bonds, for money paid, labor done, or property actually received."

In this case the Court holds that the word "for" money, in the constitutional provision is used in the sense of "In place of", the purpose being to prevent the issue of stock or bonds unless the corporation receives in place of the same, an amount in value in money, labor &c., equal to the bonds.

A recent construction of the constitutional and statutory provisions of Missouri by the same Court is to the same effect: CASS BANK & TRUST CO v. SHEEHAN, and IN RE SCHORR-KOLKSCHNEIDER BREWING COMPANY, C. C. A. 8th Circuit, (1938) 97 F. (2d) 935:

In LYON v. BLEEG; In RE DAKOTA PLOW & WAGON CO., 240 F. 405 (1917), the Circuit Court of Appeals for the 8th Circuit, held:

> "Under South Dakota's Constitution, Article 17 Paragraph 8 providing that no corporation shall issue stocks or bonds except for money, labor done, or property actually received, and that all fictitious increase of stock or indebtedness shall be void, the bonds of a corporation of that State issued and pledged to secure an antecedent debt and with no consideration other than an extension of time for paying the debt are void."

The Circuit Court of Appeals for the 9th Circuit, considered a similar provision of the Constitution of the State of Washington in the case of HASKELL v. McCLINTIC-MARSHALL COMPANY, 289 Fed. 405 (1923). The constitution prohibited the issuance of corporate securi-

ties "except for money or property received or labor done". The Court held that a mortgage given by a corporation to a trustee and by the trustee assigned to a bank to secure an *antecedent* debt owing to the bank by the corporation is null and void.

The statutes and constitutional provisions of the states above named grew out of the same economic conditions which caused the embodiment of a like principle into a fundamental law of Pennsylvania. All were aimed at the prevention of the same economic abuse. They were adopted for the purpose of compelling corporations to reflect their true financial condition in their balance sheets, to show that for every security issued that was charged on the liability side there was a corresponding asset on the other side, that for every security issued—be it stock or bond—the corporation received in exchange something of corresponding value.

If the constitutional provision in question is to be construed that bonds may be issued not in extinguishment of debts but merely as a pledge to secure antecedent debts then, to use the case at bar as an illustration, it would have been possible for a prospective creditor of the Company to examine its financial statement a few days before the pledging of these bonds, October 23, 1938, and examine the property of the Company and see that there was a large bank indebtedness but on the other hand there was a large physical property which was unencumbered or, at least, for a very small amount, and that if such prospective creditor extended credit, he with the Bank had an equal claim upon the physical property, with the feeling that if any additional bonds then authorized were to be issued it would bring into the company an additional and corresponding asset in money or property. The same would be true of a prospective bond buyer, or a prospective stock buyer.

It is the Petitioner's contention that this was not the construction the framers of the Constitution intended. The plain construction of the language used in the pro-

vision is that when you issue and hand out a bond, you get something *for* what you give and you give something *for* what you get, and not for what you already have. All of the states, with two exceptions, where similar clauses have been construed, have decided in accord with petitioner's contention. The Circuit Court of Appeals for the Third Circuit, inferred at least in two cases the soundness of that construction. The Superior Court of Pennsylvania and one of its outstanding Common Pleas Courts also found the soundness of that proposition.

Since the decision of the Circuit Court in this case is in conflict with all these authorities, and the question involved is an important one, a ruling by this Court is necessary to resolve the conflict and dispel the resulting uncertainty.

CONCLUSION

It is respectfully submitted that, for the reasons stated, this Petition for a Writ of Certiorari should be granted.

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